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FISCAL IMPACT STATEMENT

LS 6601 **NOTE PREPARED:** Feb 2, 2004
BILL NUMBER: HB 1006 **BILL AMENDED:** Jan 15, 2004

SUBJECT: Property Tax Deduction Increases.

FIRST AUTHOR: Rep. Welch **BILL STATUS:** As Passed House
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL **IMPACT:** State & Local
X DEDICATED
FEDERAL

STATE IMPACT	FY 2004	FY 2005	FY 2006
State Revenues	(18,000)	13,564,000	13,622,000
State Expenditures	(980,000)	(2,380,000)	(700,000)
Net Increase (Decrease)	962,000	15,944,000	14,322,000

Summary of Legislation: *Property Tax Deductions:* This bill increases the deduction amount for the following: (1) elderly deduction; (2) blind or disabled deduction; (3) 10% disabled veteran's deduction; (4) 100% disabled or elderly veteran's deduction; (5) WWI surviving spouse deduction; (6) WWI veteran's deduction; (7) one- and two-family dwelling rehabilitation deduction; (8) 50-year-old home rehabilitation deduction; and (9) residentially distressed area deduction. The bill allows a property owner to determine the year in which a five-year residential rehabilitation period begins and allows a property owner to revive a deduction not taken for the assessment date in 2003 or an earlier year.

Circuit Breaker: This bill also dedicates revenue generated by a 0.1% increase in the Corporate Adjusted Gross Income Tax rate to 8.6% and a 0.1% increase in the Utility Receipts Tax rate to 1.5% to freeze the property taxes of resident homeowners who are at least 65 years of age and whose adjusted gross income does not exceed $25,000. The bill makes an appropriation.

Effective Date: Upon passage; July 1, 2004.

Explanation of State Expenditures: **The total impact on state expenditures from the Property Tax**

Replacement Fund from all provisions of this bill is estimated at reductions of $980,000 in FY 2004, a $2.4 M in FY 2005, and $700,000 in FY 2006. In CY 2006, the total PTRF cost would increase by about $460,000 and would grow in later years. The Property Tax Replacement Fund (PTRF) is annually supplemented by the state General Fund, so any change to expenditures from this fund would ultimately affect the state General Fund.

Property Tax Deductions: The increased deductions in this proposal would cause a reduction in homesteaders' property tax bills which would result in a savings of homestead credit expenditures. The savings are estimated at $800,000 in FY 2004 and $2.4 M in all other years.

The increased deductions would cause part of homeowners' tax burdens to be shifted to business personal property beginning in CY 2004. The state pays the 60% school general fund PTRC on all property, however, business personal property does not qualify for the regular 20% PTRC. The state's expense for PTRC would be reduced by an estimated $185,000 in FY 2004 and $550,000 in all other years.

Both PTRC and Homestead Credits are paid from the PTRF.

Circuit Breaker: This credit would cost the state approximately $570,000 in FY 2005, $2.3 M in FY 2006, and $3.9 M in FY 2007. The credit would be paid from the PTRF.

Property taxes for individuals over 65 owning homesteads were estimated for 2003 pay 2004 (CY 2004) and 2004 pay 2005 (CY 2005) using CY 2001 state income tax data. The estimated number of taxpayers eligible for this credit is estimated to be 111,000 in CY 2005, with a total credit of $1.70 M. In CY 2006 it is assumed that the total number of eligible taxpayers will increase to 112,000 with a total credit for the increase between CY 2005 and CY 2006 property taxes of $1.75 M. Taxpayers who were eligible in CY 2005 and remain eligible in CY 2006 will also receive a credit equal to the credit they received in CY 2005; it is assumed that 5.2% of those eligible in CY 2005 will no longer claim the credit and that the total credit in CY 2006 will be $1.75 M + 94.8% of $1.70 M, or $3.36 M. In CY 2007 an additional $1.79 M in new credits will be added as the number of eligible taxpayers increase. However, 5.2% of those taxpayers first eligible in CY 2006 will no longer claim the credit, and an additional 5.2% of those taxpayers first eligible in CY 2005 will also no longer claim the credit, increasing the total credit for CY 2007 to $4.80 M.

NOTE: The bill specifies that the circuit breaker applies to property taxes payable after December 31, 2004, so this analysis assumes that the increase in property taxes is from the 2004 base. However another section of the bill requires that the taxpayer file a form to claim the credit before May 11 before the first year for which the credit is to be obtained. The effective date of this provision is July 1, 2004, so taxpayers may not be able to claim the credit until Pay 2006.

Tax Increases: The Department of State Revenue will have administrative expenses associated with amending tax returns, instructions, and computer programs to adjust for the tax increases in July 2004.

<u>**Explanation of State Revenues:**</u> **The total impact on state revenues from the increases in the property tax deductions, the Utility Receipts Tax, the corporate Adjusted Gross Income Tax, and the impact on the individual Adjusted Gross Income Property Tax Deduction is a revenue loss of $18,000 in FY 2004, and a revenue increase of $13,564,000 in FY 2005 and $13,622,000 in FY 2006.**

Property Tax Deductions: The state levies a small tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. The total revenue reduction under this proposal is estimated at $18,000 in FY 2004 and $36,000 each year thereafter.

Circuit Breaker- Tax Increases: This bill increases the Utility Receipts Tax (URT) from 1.4% to 1.5% and increases the corporate Adjusted Gross Income Tax (AGI) from 8.5% to 8.6%. The incremental increase in these taxes are directed to the Property Tax Replacement Fund (PTRF). The tax increases are effective July 1, 2004. Based on the January 12, 2004, Revenue Forecast, the increase in the URT is expected to raise approximately $7.7 M annually and the increase in the corporate AGI is expected to raise approximately $5.9 M annually for a total increase of $13.6 M in revenue. This incremental increase in revenue will be deposited in the PTRF beginning in FY 2005.

Individual AGI Property Tax Deduction: The reduced property taxes paid by these individuals will also reduce the amount of the property tax deduction taken on their individual income tax returns and effectively increase individual adjusted gross income tax revenue by approximately $58,000 in FY 2006 and $114,300 in FY 2007.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) *Property Tax Deductions:* Under current law, the property tax deductions for the elderly, blind/disabled, and 100% disabled veterans are equal to $6,000 AV. The elderly deduction is further limited to ½ of assessed value. The WWI veterans and their surviving spouse deductions are currently set at $9,000 AV. The wartime service-connected disabled veterans' deduction equals $12,000 AV, and the 100% disabled veteran deduction equals $6,000 AV. This bill would increase all of these deductions by about 108%.

For taxes paid in 2002, the statewide total of all of these deductions was $1.219 B AV. The higher deduction amounts and higher qualifying income for the elderly deduction would result in additional deductions estimated at $1.5 B AV.

Beginning in CY 2004 this proposal would cause a shift of part of the property tax burden from homeowners to all property owners in the form of a higher tax rate. **The net tax shift from those homeowners who receive the additional deductions to all taxpayers is estimated at about $29.3 M in CY 2004, $29.8 M in CY 2005 and $29 M each year thereafter.** A portion of the shift, as much as 30%, would fall back onto homesteaders as they too would pay the higher tax rate. **The net tax shift from the entire homeowner class to taxpayers in other property classes is estimated at about $20.5 M in CY 2004, $20.9 M in CY 2005, and $20.3 M per year thereafter.** Total local revenues, except for cumulative funds, would remain unchanged. The revenue for cumulative funds would be reduced by the product of the fund rate multiplied by the deduction amount applicable to that fund. The bill would require the DLGF to recompute 2004 tax rates to take into account the AV reduction resulting from this bill.

The following table summarizes the changes in AV deducted for the above deductions.

Deduction Type	2002 Deduction	Estimated 2004 Deduction	Increase
Elderly	$611.6 M	$1,461.8 M	139%
Blind or Disabled	199.2 M	414.2 M	108%
Veterans (Combined)	407.9 M	848.5 M	108%
Total	**$1,218.7 M**	**$2,724.5 M**	**124%**

The bill also makes changes to the rehabilitated property deductions. The residential property rehabilitation deduction currently equals up to $9,000 AV per unit for five years. This deduction may be claimed for five years. The maximum deduction would increase to $18,720 per unit under this bill. In addition, under current law, the deduction only applies if the total assessed value prior to rehabilitation did not exceed $18,000 AV for a single-unit home or $24,000 for a two-family home. These AV caps would also be increased by 108%.

The historic property rehabilitation deduction for structures at least 50 years old currently equals up to $60,000 AV for single-family dwellings and up to $300,000 AV for any other type of property. This deduction may be claimed for five years. This bill would increase the maximum deduction for single-family dwellings to $124,800. The maximum deduction for other types of property would increase to $500,000, a 66.7% increase.

The deduction for rehabilitated property in a residentially distressed area currently equals up to $96,000 AV, depending on whether the property contains one, two, three, or four units. This bill would increase each of the caps by 108% up to $199,680 AV for four-family dwellings.

Currently, the residential property rehabilitation deduction and the historic property rehabilitation deduction for structures at least 50 years old may be claimed for five years beginning with the year in which the increase in AV from the rehabilitation occurs. For rehabilitation before 2004, this bill would allow a taxpayer who never filed, but qualified, for the deduction to still claim a full five years. In addition, for claims regarding rehabilitation that occurs after 2003, taxpayers would be permitted to file for a deduction in any year after they are qualified. The deduction would last for 5 years including the initial year in which it was filed. This provision could also increase deduction levels for the above deductions for about 5 years by an unknown amount.

The value of these rehabilitation deductions is commingled with real property abatements on the auditor's abstract, making it impossible to quantify the current deductions. The total of all real property abatements plus rehabilitation deductions in 2002 was $2.0 B AV. Real property abatements most likely make up the overwhelming majority of this aggregate number, leaving a smaller amount representing rehabilitation deductions. The increase for these deductions is not considered in the above shift estimates.

Circuit Breaker: This provision would have no effect on local revenues.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue.

Local Agencies Affected: Local civil taxing units and school corporations; County Auditors.

Information Sources: 2002 and 2003 County Auditors' Abstracts; Local Government Database; January 12, 2004, Revenue Forecast.

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